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'Minilateral' Development Banks: What the Rise of Africa's Trade and Development Bank (TDB) says about Multilateral Governance

Chris Humphrey

ABSTRACT

Multilateral development banks (MDBs) are one of the most popular forms of international organization, with at least 28 operating in the world today. Although most academics and policy makers focus on the World Bank and major regional MDBs, the majority of MDBs are in fact relatively small, and controlled by developing as opposed to industrialized countries. How does the differing governance arrangements of these 'minilateral' development banks (MnDBs) impact their operations? This article takes the Trade and Development Bank, an MDB in Africa with 22 country shareholders, as a case study to consider this question. Based on an analysis of its track record since 2005 and interviews with management and shareholders, the author finds that borrower-led governance leads to substantial disadvantages in terms of access to finance. Borrower-led governance permits TDB and other MnDBs greater operational flexibility, which partially compensates for this financial disadvantage, but these operational strategies come with trade-offs in terms of developmental effectiveness. The findings suggest that MnDBs have substantial latent potential and, in an increasingly multipolar world, they are likely to grow in coming years. However, MnDBs need to ensure that their developmental value added strengthens in step with their financial power.

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INTRODUCTION

Of the myriad forms of international organizations that have proliferated since the second half of the 20th century, multilateral development banks (MDBs) have proven particularly popular. Following the founding of the World Bank in 1944, at least 28 MDBs now operate (see Appendix Table A1). Judging by the recent creation of the Asian Infrastructure Investment Bank and New Development Bank, MDBs appears to have continued relevance in global development finance.

Most academic and popular attention to date has focused on the World Bank and the major regional MDBs — the African Development Bank (AfDB), Asian Development Bank (AsDB), European Bank for Reconstruction and Development (EBRD) and Inter-American Development Bank (IDB).[1] This is no surprise, given their size, influence in global development and geopolitical role. It is difficult to think of the World Bank Group, with an outstanding portfolio of over US$ 350 billion,[2] as comparable with the East African Development Bank (EADB), with a loan portfolio nearly 2,000 times smaller. Despite their vast disparity in scale, all MDBs follow the same basic blueprint: they are created by a group of like-minded countries who contribute share capital and own the MDBs; they borrow money from external sources (often private investors); and they on-lend that money for development projects in some or all of their member countries.

In absolute numbers, most MDBs are actually more like the EADB than the World Bank. Not only are they for the most part quite small, but they are also mostly controlled by the same countries in which they operate — unlike the larger MDBs which are mainly controlled by non-borrower, industrialized countries[3] (Figures 1 and 2). Africa has five borrower-led

[1] The literature on MDBs is vast, but a few key works to mention include Babb (2009) on the role of the USA as shareholder; Culpeper (1997) and Griffith-Jones et al. (2008) on regional MDBs); IDS (2001) on MDBs as a system; Kapur et al. (1997) on the World Bank; Kellerman (2018) on the proliferation of MDBs generally; Tussie (1995) on the IDB; Woods (2006) on the World Bank and International Monetary Fund (IMF).

[2] Including all four main financing windows of the World Bank Group.

[3] Borrower countries formally have a majority of voting power at the AfDB and IDB, but this power is limited due to (1) the extreme dependence of AfDB on concessional resources donated by wealthy shareholders and (2) the formal veto power of the USA over key decisions at the IDB.

MDBs — more than any other continent — the largest of which is the Trade and Development Bank (TDB) (Table 1).

[Figure 1; Figure 2; and Table 1]

For want of a better term, this article labels these institutions 'minilateral development banks' (MnDBs), which refers to MDBs that were created and are still run by developing countries themselves, and are generally smaller in size compared to the World Bank and major regional MDBs. The term is inexact, as the Development Bank of Latin America (CAF) is nearly as large as the AfDB in terms of assets, and several other of these MnDBs are growing quickly. However, while acknowledging its limitations, MnDB is a useful shorthand for the type of organization analysed here.

This article argues that despite their relatively modest size, MnDBs are highly relevant in both academic and policy terms.

- In *academic terms*, MnDBs provide a useful lens for considering the governance of multilateral organizations — a topic of considerable scholarly attention, but mainly in relation to organizations dominated by industrialized countries.[4] How does governance control by mainly borrower country shareholders impact MnDB characteristics and activities, and does this differ systematically from MDBs controlled by non-borrowers? This continues my earlier research that focused on MDBs in Latin America (Humphrey, 2014, 2015a, 2016) and is in line with other scholars (for example, Copelovitch, 2010; Lyne et al., 2009) who look at governance influence in international organizations beyond the role of a single powerful shareholder. This topic is becoming increasingly relevant in a geopolitical context in which the power of the USA and G7 has been steadily eroding.
- In *development policy terms*, many MnDBs have begun growing rapidly after years of relative dormancy. One — the Development Bank of Latin America (CAF) — has expanded very dramatically, suggesting that other MnDBs could also have

[4] For studies of MDBs focusing on the role of a few powerful shareholders, see among many examples, Babb (2009); Dreher and Vreeland (2014); Kersting and Kilby (2016); Krasner (1981); Woods (2006).

considerable growth potential. Their control by developing countries may play a role in this, as the post-war global governance order begins to fragment and developing countries take greater control of their own development trajectories, and as financial globalization offers improved access to resources. With a better understanding of the challenges and opportunities facing MnDBs, policy makers can more usefully incorporate them into the international development finance architecture to play a role in the global development agenda.

This article takes as a case study the TDB, the largest borrower-led MnDB in Africa, which currently has 22 members.[5] An MnDB in Africa was chosen because of the overwhelming importance of development finance in the region, given its high development needs and relatively lower flows of private external finance (compared to Latin America or Asia, for example). Should the five MnDBs in Africa be able to provide substantially more development finance, it would be a valuable contribution to addressing the continent's tremendous needs. From the five African MnDBs, TDB was chosen because of its very strong recent growth trajectory, which may offer lessons for other MnDBs. Some examples and data from MnDBs in other regions are occasionally included for comparative purposes and to enrich the discussion.

The principal research questions considered by the article are:

- How does the borrower-led governance of TDB and other MnDBs shape their ability to undertake their development mission, compared to the World Bank and major regional MDBs?
- What explains TDB's impressive recent lending growth, in light of the obstacles it faces due to its membership structure and operating environment?
- What trade-offs do TDB and other MnDBs face between financial solvency and developmental impact?

[5] Borrower country shareholders are: Burundi, Comoros, DR Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Malawi, Mauritius, Mozambique, Rwanda, Seychelles, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. Non-borrower country shareholders are Belarus and China.

The evidence presented below is the result of a detailed examination of TDB's financial performance and lending activities since 2005 (the earliest year for which information is available), compared to similar data from other MDBs. I also carried out a detailed review of TDB annual reports, background documents and credit rating agency reports, and undertook a series of interviews with current and former TDB senior management in the period February to June 2017 (see Appendix Table A2 for a complete list of interviews).

Following this introduction, the next section briefly traces the historical trajectory of TDB and outlines its governance set-up. The subsequent two sections then look at the challenges facing TDB in accessing finance, and consider its operational innovations for addressing those challenges. The concluding section draws together the main findings.

BACKGROUND TO MNDBs IN AFRICA AND THE CREATION OF TDB

It may come as a surprise that Africa has more 'home-grown' multilateral development banks than any other continent. The impetus for the burst of MDB creation derived initially from the desire of newly independent African nations in the 1960s and 1970s to stimulate rapid economic growth and industrialization through regional economic integration. The United Nations Economic Commission for Africa (UNECA) played an important role, encouraging African nations to create the AfDB in 1963 (Mingst, 1990; Mwale, 2001; UNECA, 2017), and subsequently designing a series of regional trade agreements across the continent. Linked to these trade agreements, a number of MnDBs were formed to help finance regional integration projects.[6] Although the original trade and regional integration agreements were (and are) by and large ineffective (see among others Kimbugwe et al., 2012), the MnDBs for the most part continue to operate.[7]

[6] Similarly, three MnDBs were created in Latin America during this period, also linked to regional integration agreements: CAF, the Central American Bank for Economic Integration (CABEI) and the Caribbean Development Bank (CDB).
[7] A sixth African MnDB, the Development Bank of the Great Lakes States, was founded in 1977 but has been dormant for some years as a result of the political and financial turbulence among member countries.

The Preferential Trade Agreement of Eastern and Southern Africa, signed in 1981, was the last of the regional integration agreements deriving from the initial push by UNECA and the Lagos Plan of Action (UNECA, 2017). After a delay of four years, the Trade and Development Bank, TDB — originally called PTA Bank due to its formal link to the trade agreement[8] — was launched in 1985. TDB operated on a very modest scale for the first 15 years of its existence. By 1999, the bank had a small portfolio, a very high stock of non-performing loans (NPL) and substantial difficulties in finding projects to fund due to the moribund state of regional trade and lack of interest by borrowers. Starting in 2000, TDB launched a series of reforms that paved the way for its subsequent growth trajectory.

TDB currently has 22 member countries plus a group of institutional shareholders, grouped into two shareholding classes (see below for details). No individual member country is permitted to have more than 15 per cent of total voting shares (TDB, 2016: Article 6), and currently no member has more than 9 per cent (TDB, 2016 Financial Statement). As a result, no member has even close to veto power in the boards of governors or directors,[9] which generally require a simple majority — or, in special cases, a two-thirds majority — for decision making. This has led to a relatively harmonious environment on the board where, according to senior management, most issues are decided by consensus. 'Everybody is a minority, there's no tail that can wag the dog here', said TDB President Tadesse. 'So that creates a very different kind of environment [from the larger MDBs], and people behave with the best interests of the institution in mind'.[10]

TDB remains substantially smaller than the main lending window of the World Bank (IBRD) as well as the major regional MDBs, as measured by both outstanding loan portfolio and annual lending commitments. However, it is far larger than any other MnDB in Africa, approaching the scale of the two main borrower-run MnDBs in Latin America, CAF and

[8] The bank was renamed TDB in spring 2017. To avoid confusion, this article uses the name TDB throughout.

[9] As with most MDBs, the Board of Governors meets once a year. The Board of Directors meets semi-regularly, but does not sit in permanent session as at the World Bank and major regional MDBs. The Board of Directors is comprised of 10 directors plus the president: five directors represent groups of three African countries; one director represents non-regional countries; one director represents the AfDB as shareholder; one director represents non-sovereign shareholders; and two directors are independent.

[10] Interview, Admasse Tadesse, TDB President, 16 May 2017.

CABEI (see Table A1), and its financial performance has improved dramatically in recent years. The size of the loan portfolio rose over 1000 per cent in the decade prior to 2015, from US$ 230 million to US$ 2.9 billion (Figure 3).

[Figure 3]

According to interviews with the current and former TDB presidents[11] and a review of annual reports, the impetus for TDB's impressive growth came from a very poor financial performance in the late 1990s, followed by shareholder insistence on internal reforms. The bank has benefited from strong leadership that gained the support of shareholders, as has also been the case for CAF (Rubio, 2015). More broadly, it would seem that TDB, like CAF before it (Humphrey, 2016; Rubio, 2015) and several other MnDBs more recently,[12] have begun to realize the potential of their institutions, and in particular, their ability to access bond markets. The drive to access bond market — rather than borrow from commercial banks or bilateral donors — has been the goal orienting many of the reforms implemented by TDB in recent years, as will be demonstrated below.

ACCESSING FINANCE: THE MAIN OBSTACLE FOR MNDBs

The chief attraction of MDBs is their core financial model. Member countries contribute a limited amount of shareholding capital to found an MDB, and the MDB then mainly pays for itself by lending resources for development projects at financial terms sufficiently low to be useful to the borrower, but at a mark-up to cover MDB administrative costs. Further contributions from member countries are only required to either increase the MDB's capacity or create funds for special purposes like helping the poorest countries.[13]

[11] Admasse Tadesse, TDB President, 16 May 2017, and Michael Gondwe, former TDB President, 22 February 2017.
[12] Several MnDBs have received their first international bond rating in recent years, including Black Sea Trade and Development Bank, West African Development Bank, East African Development Bank, Eurasian Development Bank, and even the Soviet-era International Investment Bank.
[13] While most special funds are quite small, they can be substantial. For example, the World Bank's International Development Association (IDA) has a loan portfolio almost as large as the Bank's 'normal' lending window (US$ 136 billion compared to US$ 169 billion as of fiscal year 2016).

For this model to function, an MDB has to have access to funding. MDBs do not take deposits,[14] which means they have to borrow most of the resources they on-lend for development projects. MDBs need to access resources at sufficiently attractive terms to be able to on-lend to borrowers at rates they can afford, while still charging a margin that pays for the bank's own administrative costs. For large MDBs, this is no problem. In fiscal year 2016 alone, the World Bank's main lending window (IBRD) issued US$ 63 billion in bonds in 21 different currencies, at a weighted average borrowing cost of 0.8 per cent — lower than almost all governments in the world (World Bank, 2016a: 28–30).

The key reason for the stellar access of the World Bank and major regional MDBs to international capital markets is an AAA bond rating. The factors shaping bond ratings of MDBs are too complex to discuss in detail here,[15] but boil down to a few key issues, foremost among them the membership and support of many of the largest and wealthiest countries in the world. The backing of rich countries — mainly in the form of 'callable capital', a type of financial guarantee — gives bond investors additional confidence that MDBs are financially safe.

Compared to the World Bank and major regional MDBs, the countries providing callable capital to TDB look far less secure. TDB's weighted average shareholder rating is only B- — nine notches below the IBRD's A- average rating and five notches below the AfDB's BB+ rating. Furthermore, the vast majority of TDB's capital — nearly 90 per cent — is below investment grade or not rated at all, while only 10 per cent is above investment grade. This is a major obstacle for MnDBs in general, and especially for MnDBs in Africa compared to less poor regions like Latin America. Two MnDBs in Latin America, CAF and CABEI, have average shareholder ratings of BB — substantially higher than TDB. As Moody's 2015 report noted, 'Many of [TDB's] shareholders are heavily reliant on foreign aid for a large portion of their foreign currency needs. As a result of these considerations, the ability of these

[14] Except in very rare cases. For example, CAF does take some deposits from member country central banks, but these form a minimal proportion of CAF's liabilities.
[15] For more, see the ratings agency methodologies (Fitch, 2017; Moody's, 2017; S&P, 2017) as well as Humphrey (2017).

member governments to quickly transfer the callable capital to the bank in the hypothetical event of an emergency is very low' (Moody's, 2015: 15).

A second issue of great importance to credit rating agencies is an MDB's capital adequacy — the size and quality of its loan portfolio in relation to a bank's own capital. Here again, TDB faces substantial difficulties. On the side of shareholder capital, the fiscal limitations of TDB member country governments make it difficult to capitalize the bank, limiting its financial capacity. TDB members have been able to contribute only a very small amount of paid-in capital (Figure 4) — a fraction of that paid into the major MDBs, and far less than the Latin American MnDBs, CAF and CABEI.

[Figure 4]

TDB's portfolio is also substantially riskier than the major MDBs. Several of TDB's member countries are among the poorest nations in the world, and the average GDP per capita of its borrower members is US$ 4,921, far below the level of the larger MDBs and also well below CAF and CABEI (Figure 5). Of TDB's 20 borrower members, 13 were included in the HIPC/MDRI debt relief initiatives,[16] and three (Somalia, Sudan and Zimbabwe) are virtual pariahs from international financial markets. Further, a substantial sub-set of TDB's member countries are currently or have recently undergone full-scale civil war or very serious political turbulence. As a result, TDB's portfolio is highly concentrated among very risky borrowers. Moody's notes, '[TDB's] activities expose it to significant credit risk due to the economically weak and politically challenging regional operating environment' (Moody's, 2015 1). This is borne out by a much higher level of NPL than other MDBs: an average of 10 per cent of the total TDB loan portfolio over 2005–2015, compared to 0.0–0.4 per cent for the World Bank, IDB and AsDB since 2010, or 3 per cent for the AfDB.

[Figure 5]

[16] The Multilateral Debt Relief Initiative for Highly Indebted Poor Countries 'allows for 100 percent relief on eligible debts by three multilateral institutions — the IMF, the World Bank, and the African Development Fund (AfDF) — for countries completing the HIPC Initiative process' (IMF, 2018).

TDB's bond rating in late 2017 was only Ba1 for Moody's and BB for Fitch — a full seven/eight notches below CAF's bond rating by the same agencies, and 10 and 11 notches, respectively, below an AAA rating. This means TDB has a much more difficult time accessing financing on reasonable terms from bond markets and commercial banks. With high funding costs, the financial terms of TDB loans to borrowers are also substantially more expensive than the major MDBs (Figure 6): 7–8 per cent on average, compared to 3–4 per cent for AfDB and 1–2 per cent for the World Bank (IBRD). Not only are the interest rates on loans much higher, but the average length of loan maturities are much lower: only one-third of TDB's outstanding loans are for longer than three years (TDB, 2016), compared to, for example, nearly three-quarters (71.5 per cent) for both AfDB and World Bank[17] (AfDB, 2016; IBRD, 2016). From the point of view of borrowers, TDB's loans are much less useful for development projects, especially long-term projects like infrastructure, because they are more expensive and very short term.

[Figure 6]

In summary, TDB faces a number of serious obstacles to accessing the resources it needs to be able to provide useful development financing services to its member countries, compared to the World Bank and larger regional MDBs. These obstacles are a direct function of its membership: 20 African countries, most of which are very poor and many of which are politically fragile, control nearly 90 per cent of the bank's shares and voting power. Building an MnDB dominated by borrower countries has a strong appeal to developing nations, as an expression of independence and a desire to diversify funding options. But this approach poses a unique set of challenges to the core financial model that underpins all MDBs, as TDB and other MnDBs have found.

MEMBERSHIP EXPANSION AND OPERATIONAL FLEXIBILITY: TDB'S STRATEGY FOR GROWTH

[17] IBRD's portfolio is 71.5 per cent over four years, hence the number would be higher for over three years. However IBRD does not report the three-year data.

This section explores the strategies TDB has followed that have allowed it to become a useful financial intermediary to its member countries, the way its governance characteristics have shaped its ability to adapt operations, and some of the trade-offs of TDB's approach compared to traditional MDBs.

Ownership Structure

In light of the substantial challenges posed by TDB's membership, it is unsurprising that reforms to the ownership structure have been a high priority. Since 2000, management has pushed to expand TDB's membership to new countries, for three principal reasons: (1) to strengthen the bank's capital base and hence lending capacity; (2) to bring in new borrowing countries to diversify and de-risk the loan portfolio; and (3) to bring in shareholders with higher sovereign ratings to strengthen TDB's own credit rating. Originally founded with nine members, TDB now has 22 sovereign shareholders and 10 institutional shareholders. This membership expansion has occurred among three main classes of shareholder.

The most substantial growth in membership has been with **borrower country governments**. TDB was originally created as an offshoot of the Preferential Trade Agreement, which subsequently became the Common Market for Eastern and Southern Africa (COMESA); bank membership was initially limited to COMESA members. TDB's early efforts focused on bringing all COMESA members in as TDB shareholders, a process which is now complete with the exception of Libya. In 2012, shareholders agreed to reform TDB's Charter to allow not only COMESA members, but all members of various trade agreements in southern and eastern Africa, as well as any neighbouring states. This modification allowed TDB to agree membership with Mozambique, and it has entered negotiations with Algeria, Angola, Botswana, Namibia and Tunisia[18] — all of which would substantially improve the average credit rating of TDB's members as well as further improve loan portfolio quality and diversification.

[18] Personal communication, TDB President Tadesse.

TDB has also attempted to attract **non-borrower country government shareholders** to strengthen TDB's bond rating. China was the first and remains the only substantial non-borrowing country[19] to join TDB, buying shares in 2000 and, as of end-2016, owning 6.2 per cent of the bank's total shares. China's inclusion has worked very well for TDB by increasing paid-in capital and supporting the bank's bond rating. Including wealthier nations like German, France and Sweden in the bank's capital would be much more helpful in this regard, and management continues to actively seek new OECD members.[20] TDB is clear on the importance of maintaining borrower control of the bank and not following the route of AfDB,[21] which was founded by African countries but now has substantial shareholding by non-borrower members.

Lastly, TDB recently created a new class of shares to bring in **institutional, non-sovereign shareholders**. The reform of the share structure in December 2012 — creating 'A' shares (for sovereign shareholders) and 'B' shares (for institutional shareholders) — was a means to channel new forms of capital into the bank, in particular reserves held by African financial institutions such as banks and pension funds. TDB first brought in an institutional shareholder (the AfDB) as far back as 1992, but in the four years from the Charter reform to the end of 2016, it has added 10 further institutions and about 26 per cent of TDB's total paid-in capital (US$ 113.4 million). 'We don't have G7 donors coming in and giving us free taxpayer money, and we don't have AAA callable capital either', said TDB President Tadesse in an interview. 'We know there's a lot of African capital, and capital worldwide that is looking for a home, provided you can give them a mix of return and risk that meets their requirements'.[22]

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[19] Oddly, Belarus has a small share of TDB equity, which TDB management explained as a result of Belarus's desire to increase its export of farm machinery to Africa.

[20] As will be discussed below, several OECD nations provide TDB with credit lines, which management views as a potential first step toward membership.

[21] To address its financial difficulties, AfDB shareholders admitted new members from developed countries in 1982, which substantially weakened African control of the bank. Although African nations still hold a formal majority, the importance of donor resources for the AfDB's concessional lending window and their support to the bank's AAA bond rating give them de facto veto over many critical issues in AfDB governance. For more on this, see Mingst (1990: 54–60) and Strand (2001).

[22] Interview, Admasse Tadesse, TDB President, 16 May 2017.

In short, TDB has added more traditional equity investors into its ownership mix, the first time any MDB has done so in a concerted way.[23] This is a creative way of working to overcome the financial challenges posed by a borrower-led MDB in Africa: offering TDB shareholders an actual financial return on their investment. Almost all MDBs are non-profit institutions — even if technically dividends are permitted, they are never distributed, and instead net income is used to build reserves or allocated for special purposes (Humphrey, 2014). To satisfy these new shareholders, TDB must generate net income each year. At the margin, this slightly increases loan costs to borrowers, since this is the main variable with which TDB can increase net income.

To reduce the impact of shareholder dividends on bank finances, a minimum 75 per cent of net income must go to reserves annually (or more, if TDB's performance was weak) for the foreseeable future. TDB distributed about US$ 2.5 million to class B shareholders in 2015, which implied about a 5 per cent return.[24] Although this is not particularly high (in a high interest rate environment such as Africa), Tadesse explained the logic: 'If you look at public service pension funds, sovereign wealth funds, insurance funds, you can give them a value proposition with a twin purpose: make returns, because that's your fiduciary duty, but you also impact development. It's almost like impact investing, you start to give a purpose to funders'.[25]

The cumulative impact of bringing in these three classes of new shareholders has been to strength TDB's financial capacity and credit rating. Ratings agencies have noted the expansion as a positive development, with Moody's stating in 2015, 'Once new member countries join, the bank could lend in them, which would help diversify its loan book and further alleviate some of the geographic concentration. It would also bring new capital to the bank. Both diversification and additional capital are credit positive developments and would help the bank maintain capital adequacy' (Moody's, 2015: 4).

[23] CAF also has a group of private banks as shareholders, but their shareholding is relatively small.
[24] Class A shareholders also receive dividends, but it must be reinvested in TDB capital until total paid-in capital reaches its authorized level (US$ 3 billion, compared to about US$ 1.5 billion subscribed currently).
[25] Interview, Admasse Tadesse, TDB President, 16 May 2017.

The strategy of bringing in different classes of shareholders has some potential pitfalls for TDB. New borrower shareholders would seem like a clear positive for the bank, in terms of increasing shareholder capital and diversifying the loan portfolio. However, inviting non-borrowers — particularly from major industrialized countries — brings with it the risk of changing the character of TDB and removing the strong sense of regional ownership. That may be a change that TDB would be willing to make, in the interests of obtaining more resources at a better cost, as AfDB chose to do and as the Asian Infrastructure Investment Bank (AIIB) has done more recently.[26] But it also means that TDB would be much more beholden to the developmental agenda of wealthy countries, which would in turn strongly shape its operations. Non-sovereign shareholders can also reshape the bank, incentivizing it to generate greater revenue to pay dividends and diluting its official, multilateral character. This could, in turn, weaken the strong official links between TDB and member governments, including the preferred creditor status on its public-sector loans.[27]

Loan Policies

TDB has followed several strategies in its lending operations that have allowed the bank to establish itself as a useful lender to its clients. The overall result is that TDB is much closer to a private financial institution than the larger MDBs, with a very strong focus on the ability of clients to repay and to manage the risks inherent in TDB's loan portfolio. While all MDBs by necessity must be concerned with these issues, at TDB the balance between commercial and developmental criteria is weighted more strongly in favour of the former compared to other MDBs. As TDB's Chief of Strategy put it, 'Projects have to be commercially viable for us to support … the projects are seen individually and they are assessed on commercial terms. Even a public sector project has to be attached to a cash flow that has to be sustainable. Otherwise we are not handing money out'.[28]

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[26] For a discussion of AIIB vs NDB governance arrangements and their potential impact on operations, see Humphrey (2015b).
[27] Preferred creditor status is informal and demonstrated through a track record of repayment to an MDB even when a country may halt payments to other creditors. TDB does not release information on non-performing loans by sovereign vs non-sovereign borrowers, and as a result, the quality of its preferred creditor status cannot be verified.
[28] Interview, Hamere Tefera, Head, TDB Strategic Management, 15 May 2017.

TDB faced a severe crisis in the late 1990s, particularly due to a very high level of non-performing loans (nearing 40 per cent of the total portfolio). To put its portfolio on sounder footing, the bank undertook a series of measures to improve the way it evaluates project risk, including the creation of the Risk Management Unit in 2006. This means, as the current president put it, 'saying no a lot' to project requests, including those that come directly from shareholder governments.[29] The stronger focus on risk since the early 2000s has led to a sharp drop in the NPL level, from over 20 per cent in 2005 of the portfolio to under 3 per cent in 2016 (Figure 7).

[Figure 7]

The structure of the loan portfolio is also dramatically different at TDB compared to the larger, traditional MDBs. In particular, TDB has since the mid-2000s focused more than half of its loan portfolio on short-term trade finance, as opposed to long-term project loans. All MDBs engage in trade finance to a degree — particularly in the wake of the global financial crisis, when commercial trade finance for developing countries dried up — but it is usually a very small fraction of overall lending. At TDB, however, it represented nearly three-quarters of the outstanding portfolio in 2016, more than double the level of just a decade previously (Figure 8).

[Figure 8]

This push into trade finance makes sense for TDB, for two main reasons. First, it matches TDB's current ability to raise finance with the needs of its clients. Because it has only limited access to capital markets to raise resources, TDB has developed relationships with numerous commercial banks based in OECD countries. Funding terms from these banks are generally too expensive and short term for major infrastructure projects — countries instead prefer to access longer-term finance for these types of projects from the World Bank, AfDB or big bilateral funders like China. However, several TDB member governments regularly import large quantities of petroleum, fertilizer or other basic goods, and need financing to facilitate

[29] Interview, Admasse Tadesse, TDB President, 16 May 2017.

these purchases. The major MDBs don't undertake this kind of transaction,[30] but TDB is happy to step in. 'We can access cheaper short-term money from European commercial banks than local corporates or sovereigns, because of our relationships with these banks', according to a TDB trade finance officer, 'so these transactions make sense for us and for our clients'.[31]

Second, trade finance is generally much safer than project finance in terms of repayment, and it is much easier to structure transactions. 'For infrastructure, the projects take long, the returns are not clear, there's performance issues, and we aren't an AAA multilateral so we can't compete with the World Bank or Chinese', said TDB's strategy officer. 'Trade is easier to do and you get your money back quickly'.[32] The majority of trade transactions have a maturity of less than six months, meaning TDB's money is recycled very quickly. Moreover, because trade transactions by definition have strong collateral (the goods being imported), TDB has considerable confidence that its exposure is well protected. Project processing is also much simpler, with few of the complications related to project feasibility, environmental and social impacts and procurement issues that come with infrastructure or social projects. For a bank like TDB, without a large staff of technical experts, this implies considerable administrative cost savings. Trade finance is a critical business line that builds the size and quality of TDB's portfolio, generates substantial revenue, and strengthens relations with major banks and clients. 'When we started with trade financing, that's when the bank really started to grow and get noticed', said former TDB President Gondwe in an interview.[33]

TDB senior management stated in interviews that they intend to build up project financing going forward, but that doing so will be based on their ability to raise long-term funding at reasonable terms. Currently, most project finance is supported by 10–15 year lines of credit from major bilateral aid agencies that have agreements with TDB, such as France's Agence Française de Développement and Germany's development bank, KfW, as well as loans by export-import banks from the China, India and elsewhere.[34] These offer longer terms and

[30] The major MDBs generally support only private sector trade financing.
[31] Interview, Jima Mengistu Bediye, Head TDB ECA Finance, 15 May 2017.
[32] Interview, Hamere Tefera, Head TDB Strategic Management, 15 May 2017.
[33] Interview, Michael Gondwe, former TDB president, 22 February 2017.
[34] See TDB's 2016 annual financial statement, pp. 51–53, for a complete list of fund sources.

lower interest rates than TDB can currently get via bond issues, due to its sub-investment grade bond rating.[35] In the meantime, trade finance is a critical business line that builds the size and quality of TDB's portfolio, generates substantial revenue from fees and interest rates and strengthens relations with major banks and borrower clients.

This use of trade finance to build the activities of the bank parallels the trajectory of CAF, another borrower-led MnDB: faced with difficulties in accessing finance and finding viable projects in the 1980s, CAF turned to trade finance to grow, with considerable success (Humphrey, 2016). TDB was created originally to finance regional integration projects, but just as CAF had experienced, TDB management found that most countries are more focused on domestic needs. 'Regional integration projects sound very good, but it's not easy to find governments willing to agree on borrowing jointly', said former President Gondwe. 'Luckily our shareholders understood this, and gave us the flexibility to move into trade finance'.[36]

While these loan strategies have been successful in solidifying TDB finances and status with borrowers as a useful financial counterpart, they have significant potential downsides from the perspective of developmental effectiveness. It is unquestionably essential for TDB to improve the quality of its loan portfolio to establish itself as a reliable financial intermediary with creditors, and hence the focus on risk and project quality is justified. However, the tone of TDB staff interviews and reporting suggests that the bank may be overly focused on this issue and in danger of losing sight of its developmental purpose. This can lead staff to seek out projects that are low risk and with strong profit generation, which can crowd out local private sector lenders who might have also supported the project, but cannot compete with TDB's financial terms. Similarly, trade finance may have some developmental impact, but it may also simply take the place of slightly higher-priced private sector finance, especially if the imports financed by these credits are simply consumption goods. The real test will be in the coming years: should TDB strengthen its bond rating and overall finances substantially and then begin to use that strength to transition to more developmentally oriented projects,

[35] Despite its disadvantages in terms of shareholder composition and region of operations, TDB's bond market access has improved in recent years. The bank issued four times on the Eurobond market for increasing amounts and at improving financial terms. The most recent issue, US$ 700 million for five years, was priced at 5.275 per cent.

[36] Interview, Michael Gondwe, former TDB president, 22 February 2017.

particularly by including clear non-commercial criteria into the loan approval process, then this strategy will have been justified from a developmental perspective.

Reduced Hassle Factor and Operational Flexibility

TDB's governance control by African borrowing countries poses several challenges, but it also offers advantages. With shareholders relatively aligned in their interests, and with the non-borrower sovereigns and institutional shareholders in a minority position (and anyway supportive of borrower country goals), the types of policy conflicts that hamper the operations of the World Bank and main regional MDBs are non-existent at TDB. This is evident in the very low level of bureaucratic 'hassle factor' faced by borrowers compared to the major MDBs.

In contrast to borrowing from private banks or issuing bonds, borrowing from MDBs often implies substantial extra time, paperwork and complicated, inflexible procedures that some countries view as an infringement on their sovereignty. Just getting a loan to final approval can take over a year on average (and longer for complex projects) at the World Bank, with another year or more before first disbursement (Figure 9). The reason is a long series of requirements imposed at the behest of major non-borrower shareholders related to project oversight, environmental and social safeguards, procurement and financial management, and development impact. To ensure compliance, non-borrower members have imposed relatively rigid, legalistic process requirements and review levels at the World Bank and at the major regional MDBs (Humphrey, 2015a).

[Figure 9]

TDB does not keep detailed data on loan approval and disbursement times, making direct comparisons impossible, but it is clearly much quicker than the World Bank and major regional MDBs, and more in line with CAF's processing times. Senior TDB management concurred that most loans take two to three months to prepare — even faster if the borrower has all necessary information ready — and the entire process from beginning to first disbursement can happen in eight months or a year for most project loans, and faster for trade finance loans. As can be imagined, such prompt service is highly attractive to borrowers, and TDB is clearly aware of its importance as part of the bank's value proposition, with senior staff mentioning it repeatedly in interviews as well as in annual reports.[37]

TDB has three levels of review for each project, compared to four or more for the World Bank, and the amount of required information, time for circulation and number of staff involved are all much reduced compared to the major MDBs. On environmental, social and procurement issues — major areas of contention at the World Bank and regional MDBs — TDB mainly relies on a country's own legal and regulatory systems, which greatly reduces required procedures, paperwork and time. Because of TDB's use of credit lines from bilateral agencies, it generally seeks to ensure projects meet the International Financial Corporation's Performance Standards, but it does so on a case-by-case basis, focusing on the specificities of each project. 'There's some countries that might not have these standards, but we are very picky about the projects', said one TDB staffer. 'We cannot impose external standards'.[38]

Final board approval is also more streamlined at TDB compared to the major MDBs. Essentially, all projects are required to be formally approved by the executive board at the World Bank and regional MDBs. However, the executive board at TDB generally meets only four times a year, rather than sitting in permanent session as at the major MDBs; outside of those meetings TDB management has authority to move ahead with certain types of projects, which are subsequently ratified by the board during the next meeting. This type of authority delegation to management is also used by the borrower-led CAF, but is virtually unheard of at the major MDBs.[39]

TDB staff have been empowered to support clients in ways that would likely raise difficulties with non-borrower shareholders at the major MDBs. For example, TDB is ready to

[37] See, for example, TDB's Annual Report 2015, p. 8.
[38] Interview, Neema Siwingwa, Principal TDB Project & Infrastructure Finance Officer, 15 May 2017.
[39] Interestingly, it seems that the new AIIB is following this borrower-led approach: the AIIB executive board does not sit in permanent session, and the AIIB president has authority to approve loans below a certain threshold.

restructure projects that are facing financial difficulties much more flexibly than at the World Bank, where project modifications often require another round of board approval. 'If a client is a week or two late, we will work with them', said one project officer. 'It is not just a financial relationship; they are our shareholders'.[40] Certain types of TDB loans might also be questioned at the larger MDBs. For example, TDB's trade finance facilities for governments importing oil essentially serve as short-term budget support operations — that type of arrangement would be very difficult to get past the World Bank board, particularly without any of the policy conditions that normally come with its budget support loans. TDB has further supported governments by directly buying government bonds, a practice that larger MDBs do not engage in. This effectively serves as a loan to the governments via market channels.

Here again, the advantages offered by borrower-led governance in permitting TDB to offer services attractive to its borrower members have potential trade-offs. While environmental and social safeguards, procurement requirements and project oversight procedures may lead to problems at the major MDBs — including excessive bureaucracy, infringement of borrower country sovereignty and imposing the views of a few powerful non-borrower countries — they also address serious issues that bedevil all development aid projects, and have contributed to raising quality standards. Taking a more flexible approach more aligned with the views of borrowers makes sense and can strengthen country ownership and internal systems. But it also runs considerable danger of lower quality standards, following inadequate local laws and ignoring serious social, environmental and transparency concerns. Not only can this lead to bad development outcomes, but it can also rebound on TDB through cancelled or delayed projects, repayment problems, particularly with private sector borrowers, and negative publicity for the institution. Should TDB follow a strategy of simply providing financing to borrowers with no concern for these issues, it may find that short-term success leads to long-term difficulties.

[40] Interview, Neema Siwingwa, Principal TDB Project & Infrastructure Finance Officer, 15 May 2017.

MAIN FINDINGS AND CONCLUSIONS

While the vast majority of academic literature examining multilateral development banks has focused on the World Bank and major regional MDBs, two dozen other MDBs are operating in the world today. Almost all these lesser-known MDBs are far smaller than their more famous institutional brethren. Moreover, almost all are controlled by the same countries that borrow from the banks — unlike the World Bank and regional MDBs, which are dominated by wealthy non-borrower countries. What challenges do these 'minilateral' development banks (MnDBs) face as a result of their membership and governance, and how might they grow to achieve greater success as development finance institutions? This question is particularly relevant in Africa, which has tremendous development finance needs, and is also home to more MnDBs (five) than any other region of the world.

This article examined the Trade and Development Bank, an MnDB with 22 member countries, based in eastern and southern Africa. Founded in 1985, TDB initially performed very poorly, but since the early 2000s has begun growing dramatically. By using TDB as a case study, the article shed light on how governance arrangements impact the operational capacity of MDBs. This follows on earlier work by the author and others looking at the CAF, a borrower-led MnDB in Latin America that has expanded tremendously in the past two decades.

TDB's experience clearly demonstrates that borrower-led governance leads to substantial disadvantages for an MnDB in terms of access to finance. Compared to the World Bank, MnDBs have mainly developing countries as shareholders, limited shareholder capital and a highly concentrated and risky loan portfolio. All of this combines to weaken access of MnDBs to sources of finance, particularly capital markets, seriously hampering their ability to supply development finance at reasonable terms — their very *raison d'être*. Because of its shareholding structure, TDB has a low bond rating and limited access to capital markets, which means it offers loans at much higher interest rates and shorter maturities than the AAA-rated MDBs, making it much less attractive as a source of development finance.

TDB's limited access to finance is very similar to the challenges faced by CAF, but even more extreme because of the weaker economic situation of TDB's shareholders and borrowers in Africa compared to counterparts in Latin America. The AAA-rated AfDB faced similar problems when it was first created in the 1960s as an entirely African-owned bank; resolving this issue was the main driver behind accepting OECD members in the early 1980s. This was also an important benefit of the AIIB's recent success in attracting European countries as members — it has received an AAA bond rating (AIIB, 2017). By contrast, the New Development Bank (NDB), with only the five BRICS countries as shareholders, still has not received an international bond rating as of June 2018.

By not taking the 'easy' route to better financial access of admitting wealthy country shareholders, TDB — like CAF before it and NDB currently — faces a difficult road to establishing itself as a useful financial intermediary for its members. Judging from its impressive growth in recent years, the strategies TDB has followed to overcome the inherent obstacles of its membership structure appear to be succeeding. Key components of this strategy include:

- Expanding shareholding among regional borrower countries and creating a new class of shares to attract non-sovereign institutional shareholders
- Focusing on risk management and the quality of the loan portfolio
- Ramping up trade finance lending as a means to increase the loan portfolio with relatively low-risk transactions better suited to TDB's financing access, which is too short-term and expensive for most infrastructure projects.
- Providing a much more streamlined administration and faster loan approval processes compared to the major MDBs
- Offering greater flexibility in dealing with client needs on a case-by-case basis, rather than requiring one-size-fits-all policies common at the major MDBs.

Several if not all aspects of this strategy are only possible because of TDB's governance arrangement. Having major industrialized countries as members is a tremendous help for an MDB's access to finance, but has numerous downsides as well, from the point of view of borrower countries. The aspects of MDB policies that recipient countries most object to are the direct result of impositions by non-borrower nations, including high levels of bureaucracy, time-consuming, rigid processes, environmental, social and procurement rules required above and beyond national laws, and financial policies favouring the interests of non-borrowers. By maintaining ownership control for borrowers, TDB and other MnDBs have much less conflictive decision-making processes and substantially greater flexibility to adapt to the needs of their borrowers. In many ways, borrower-led MnDBs like TDB are closer to a classic cooperative bank, without the 'us and them' dynamics of the larger MDBs.

At the same time, aspects of TDB's strategy to overcome the obstacles of being a borrower-run MnDB have trade-offs that can limit its development effectiveness. The admission of institutional shareholders could lead to a greater focus on income generation, which could lead to higher loan prices for borrowers. A strong focus on reducing risks in the loan portfolio to improve TDB's credit rating — limiting lending to projects that generate revenue and emphasizing trade finance — could lead to the bank becoming too 'businesslike', less interested in development impact and potentially crowding out the private sector. Reduced bureaucracy and faster loan approvals could lead to low-quality projects or unintended consequences, including social and environmental harm or corruption in procurement. In short, TDB must take care not to become so obsessed with improving its credit rating that it becomes, in practice, not much more than a commercial bank that happens to be owned by governments. TDB should follow its strategies in the near term to offset the limitations imposed by its governance arrangements, and in the medium term, as the bank builds its financial strength, transition to a greater emphasis on developmental outcomes. Otherwise, it may be in danger of using short-term strategies that ultimately undermine the TDB's financial viability, reputation and developmental impact in the longer term. A critical point would be for TDB to begin instituting clear developmental criteria in its project selection as well as ex-post evaluations of projects — both of which appear to be lacking.

Despite a relatively poor historical track record, MnDBs have substantial latent potential. This is clearly demonstrated by CAF — which now lends as much as the World Bank in its borrower countries — and the story of TDB provided here shows that such a successful transformation is possible even in a poorer region like Africa. Although still smaller than TDB, the West African Development Bank (BOAD) shows signs of moving in the same direction, with a growing portfolio, professionalized management and now a bond rating. The challenge for these MnDBs is to find a strategy that addresses the (mainly financial) obstacles inherent in being owned by a group of borrower countries with little or no outside support, while still providing developmentally relevant services to their members. If they do not succeed, this borrower-led model of multilateral finance could result in MnDBs simply providing finance with little developmental value-added. The goal should be to evolve high standards and ambitious development outcome targets, but ones that are more in line with the values and vision of the developing countries themselves compared to the non-borrower controlled major MDBs.

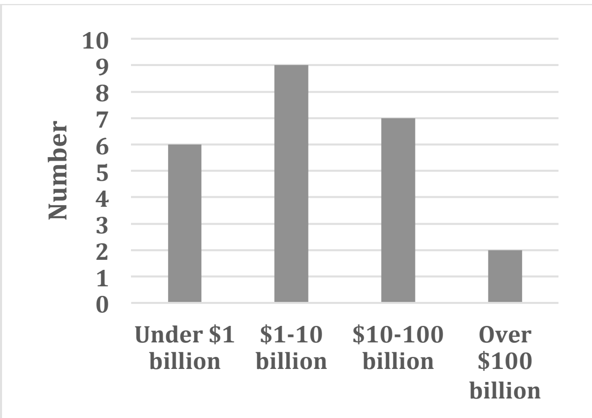
FIGURES AND TABLES

Table 1. Borrower-led MDBs in Africa

	Founded	Members	Borrower Vote Power	Assets (US$ millions)	Annual Financing (US$ millions)[a]
Trade and Development Bank (TDB)	1985	22	81.3%	4,095	3,657
West African Development Bank (BOAD)	1976	13	93.7%	2,924	485
Ecowas Bank for Investment and Development (EBID)	1979	15	100%	767	129
East Africa Development Bank (EADB)	1967	4	87%	381	184
Central African States Development Bank (BDEAC)	1975	9	51%	412	347

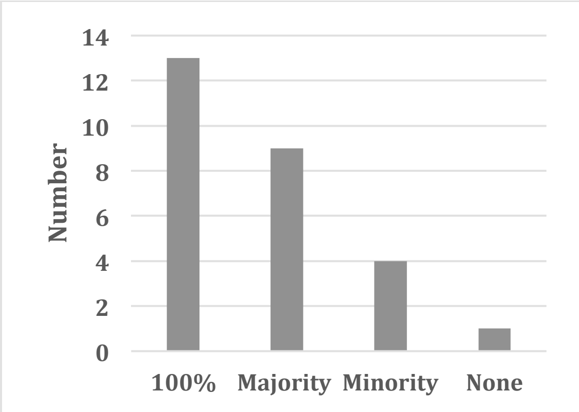
Note: [a] Includes project loans, trade financing, guarantees and equity investments.
Source: websites, annual reports and financial statements, TDB, BOAD, EBID, EADB, BDEAC.

Figure 1. MDB Total Asset Size, 2015



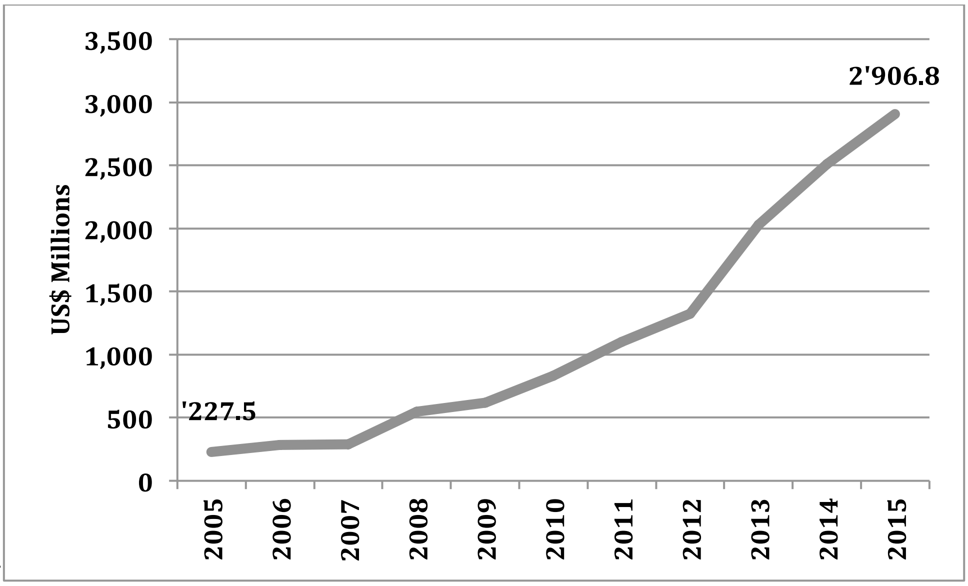
Source: 2015 annual reports for all MDBs

Figure 2. MDB Borrower Voting Power



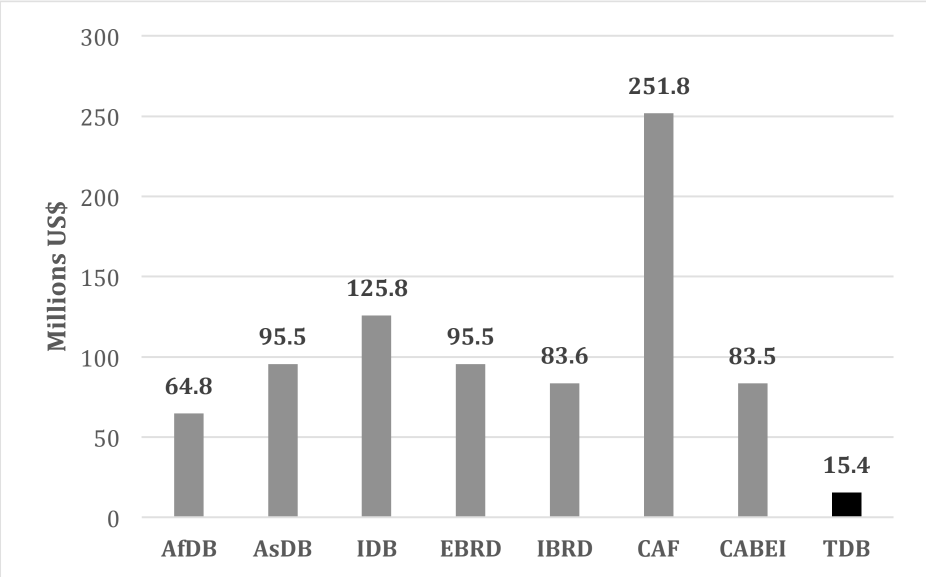
Source: 2015 annual reports for all MDBs

Figure 3. TDB Loan Portfolio (Year-end), 2005–2015



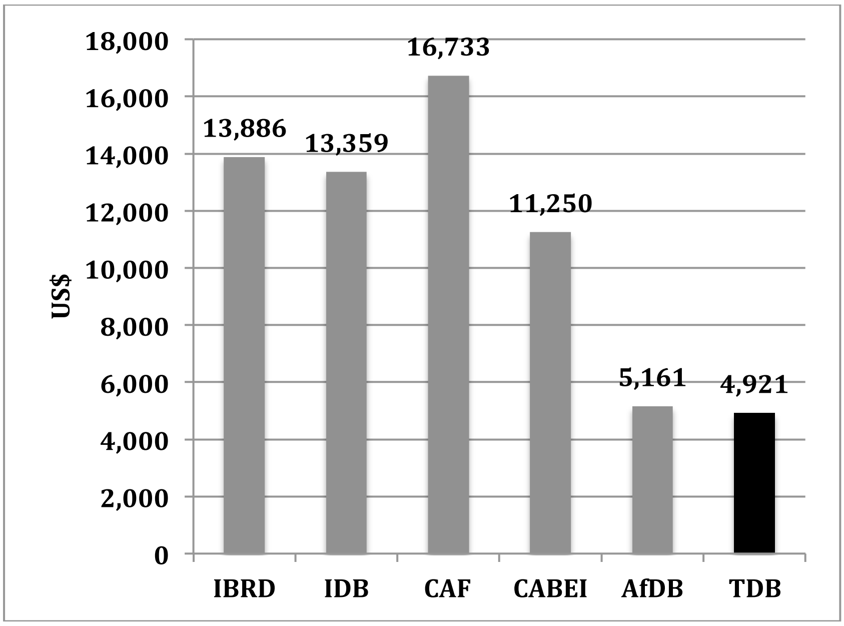
Source: Annual financial statements, TDB (2005–15)

Figure 4. Average Paid-in Capital per Shareholder



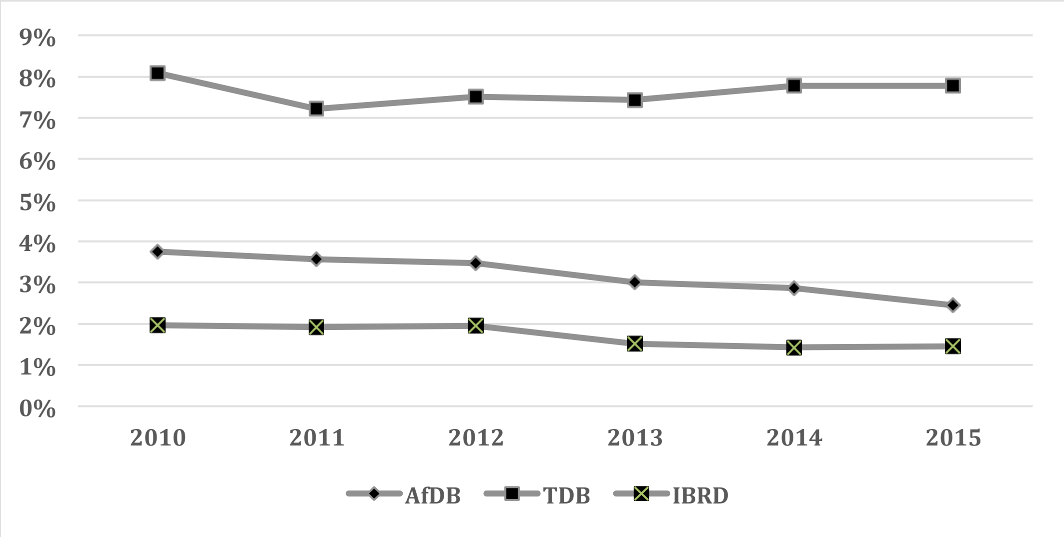
Source: Financial statements, selected MDBs (2015)

Figure 5. Average GDP per Capita of Borrower Members (PPP, 2016)



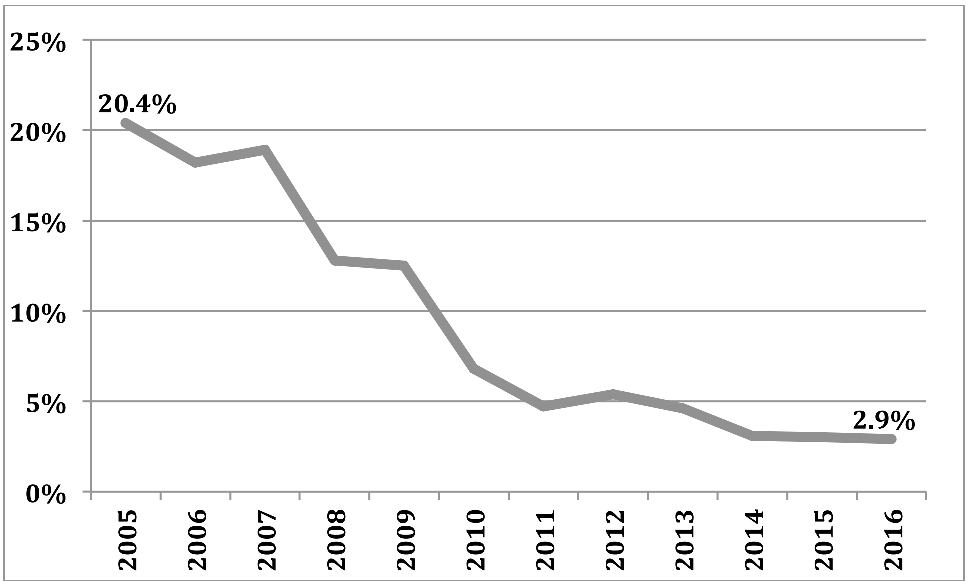
Source: World Development Indicators; http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators (accessed 15 August 2017)

Figure 6. Interest Rate Charged to Borrowers



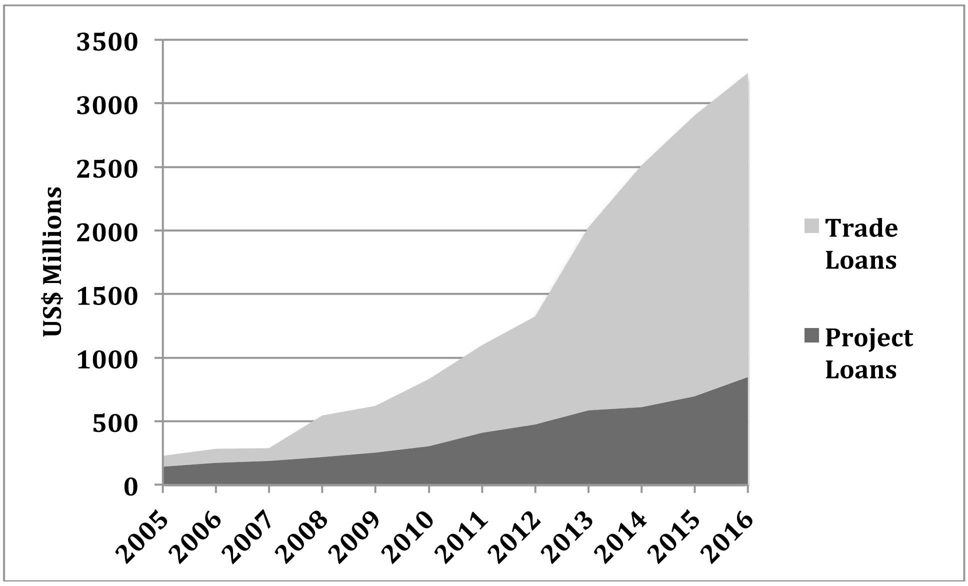
Note: Interest rate charges for TDB and AfDB are for combined private and public borrowers, while IBRD is for public borrowers only.
Source: Annual financial statements, AfDB, TDB and World Bank (2010–15)

Figure 7. Non-performing Loans as % of Loan Portfolio



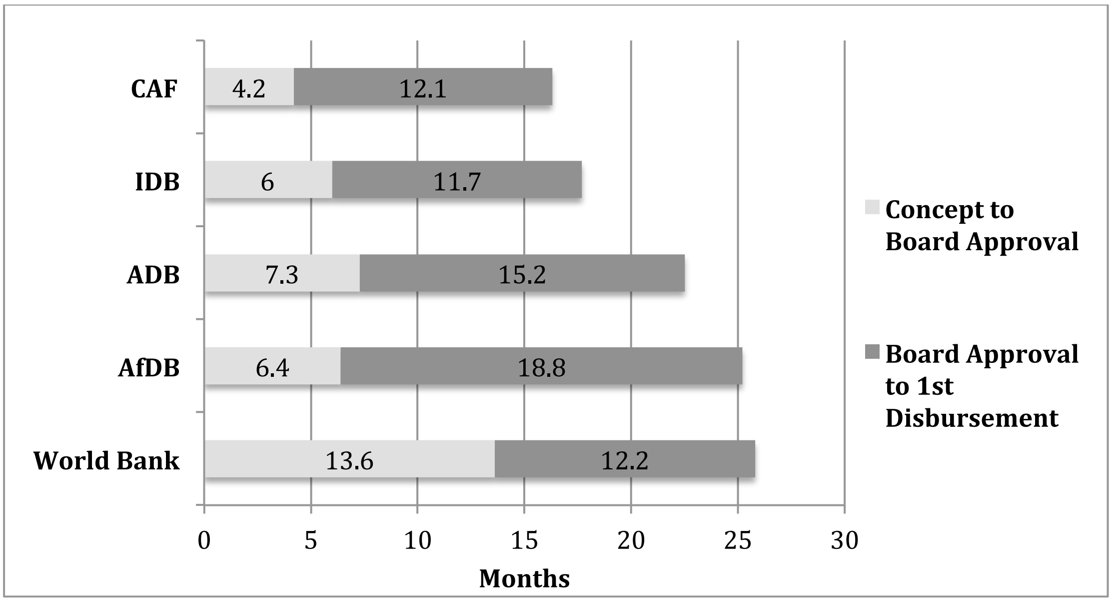
Source: Annual financial statements, TDB (2005–16)

Figure 8. Trade and Project Loans in TDB Loan Portfolio



Source: Annual financial statements, TDB (2005–16)

Figure 9. Average Loan Approval and Disbursement Times (2014/15)



Notes: Investment projects only for World Bank; investment and budget support for others. Sovereign guarantee projects only except for AfDB, which is average of sovereign and non-sovereign operations. World Bank and AfDB average concessional and non-concessional; AsDB and IDB non-concessional only.
Sources: AsDB (2015); IDB (2015); World Bank (2015); AfDB personal communication; CAF personal communication.

APPENDIX

Table A1. Multilateral Development Banks in Operation (2015)

	Founded	**Members**	**Borrower Vote Power**	**Assets (US$ millions)**[a]	**Annual Financing (US$ millions)**[b]
Africa					
African Development Bank (AfDB)	1964	81	60.0%	35,131	6,061
Trade and Development Bank (TDB)	1985	22	81.3%	4,095	3,657
West African Development Bank (BOAD)	1976	13	93.7%	2,924	485
Ecowas Bank for Investment and Development (EBID)	1979	15	100%	767	129
East Africa Development Bank (EADB)	1967	4	87%	381	184
Central African States Development Bank (BDEAC)	1975	9	51%	412	347
Middle East[c]					
Islamic Development Bank (IsDB)	1975	57	100%	22,198	10,900
Arab Bank for Economic Development in Africa (BADEA)	1976	18	0%	4,269	410
Americas					
Inter-American Development Bank (IDB)	1959	48	50.01%	111,139	10,404
Development Bank of Latin America (CAF)	1970	19	100%	32,470	12,255
Central American Bank for Economic Integration (CABEI)	1960	13	67.3%	8,813	1,860
Inter-American Investment Corporation (IIC)	1985	45	64.0%	1,505	346
Caribbean Development Bank (CDB)	1970	28	55.2%	1,407	294

FONPLATA	1974	5	100%	628	284
Eastern Europe/ Central Asia					
Eurasian Development Bank (EDB)	2006	6	100%	2,880	59
Black Sea Trade and Development Bank (BSTDB)	1999	11	100%	1,405	531
International Investment Bank (IIB)	1970	9	100%	882	186
Europe					
European Investment Bank (EIB)	1958	28	100%	621,973	102,426
European Bank for Reconstruction and Development (EBRD)	1991	65	13%	59,978	10,222
Nordic Development Bank (NDB)	1976	8	100%	29,769	3,085
Council of Europe Development Bank (CEDB)	1956	41	100%	27,376	2,508
Asia					
Asian Development Bank (AsDB)	1966	67	38.5%	117,697	13,416
Pacific Islands Regional Development Bank (PIRDB)	1989	8	100%	12	2
Asian Infrastructure Investment Bank (AIIB)[d]	2016	52			
Global					
International Bank for Reconstruction and Development (IBRD)	1944	189	37.1%	343,225	23,528
International Finance Corporation (IFC)	1956	184	37.1%	87,548	10,539
New Development Bank (NDB)[d]	2016	5	100%		

Notes: Data are for 2015, except for IsDB, Ecowas and BDEAC, which are all from 2014. Only non-concessional lending windows are included, as concessional lending windows are technically trust funds managed by MDBs (although the World Bank's IDA may soon qualify as it has recently received a bond rating to issue debt).

[a] The outstanding loan portfolio makes up a weighted average of 64% of assets for all MDBs, with a low of 20% (International Investment Bank) and a high of 92% (Pacific Islands Regional Development Bank).
[b] Includes project loans, trade financing, guarantees and equity investments.
[c] Neither IsDB nor BADEA are formally focused on the Middle East region, but the majority of their members are from the region.
[d] Asian Infrastructure Investment Bank and New Development Bank have only just begun operations and hence do not have meaningfully comparable data. Country eligibility for AIIB has not been clearly defined, hence voting power of borrower members could not be calculated.

Sources: Annual reports and financial statements

Table A2: Complete list of Interviews

Abraham Byanyima	TDB Treasurer	29 June 2017
Eston Eston Chimkono	Principal TDB Portfolio Management Officer	16 May 2017
Michael Gondwe	Former TDB President (2001–11)	22 February 2017
Mohamed Kalif	Executive Director representing AfDB on TDB's executive board	16 February 2017
Jima Mengistu Bediye	Head, TDB ECA Finance	15 May 2017
Neema Siwingwa	Principal TDB Project & Infrastructure Finance Officer	15 May 2017
Admasse Tadesse	TDB President	16 May 2017
Hamere Tefera	Head, TDB Strategic Management	15 May 2017

All interviews undertaken in TDB offices in Nairobi, Kenya, except for Michael Gondwe and Mohamed Kalif (by telephone from Zambia and Cote d'Ivoire, respectively).

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